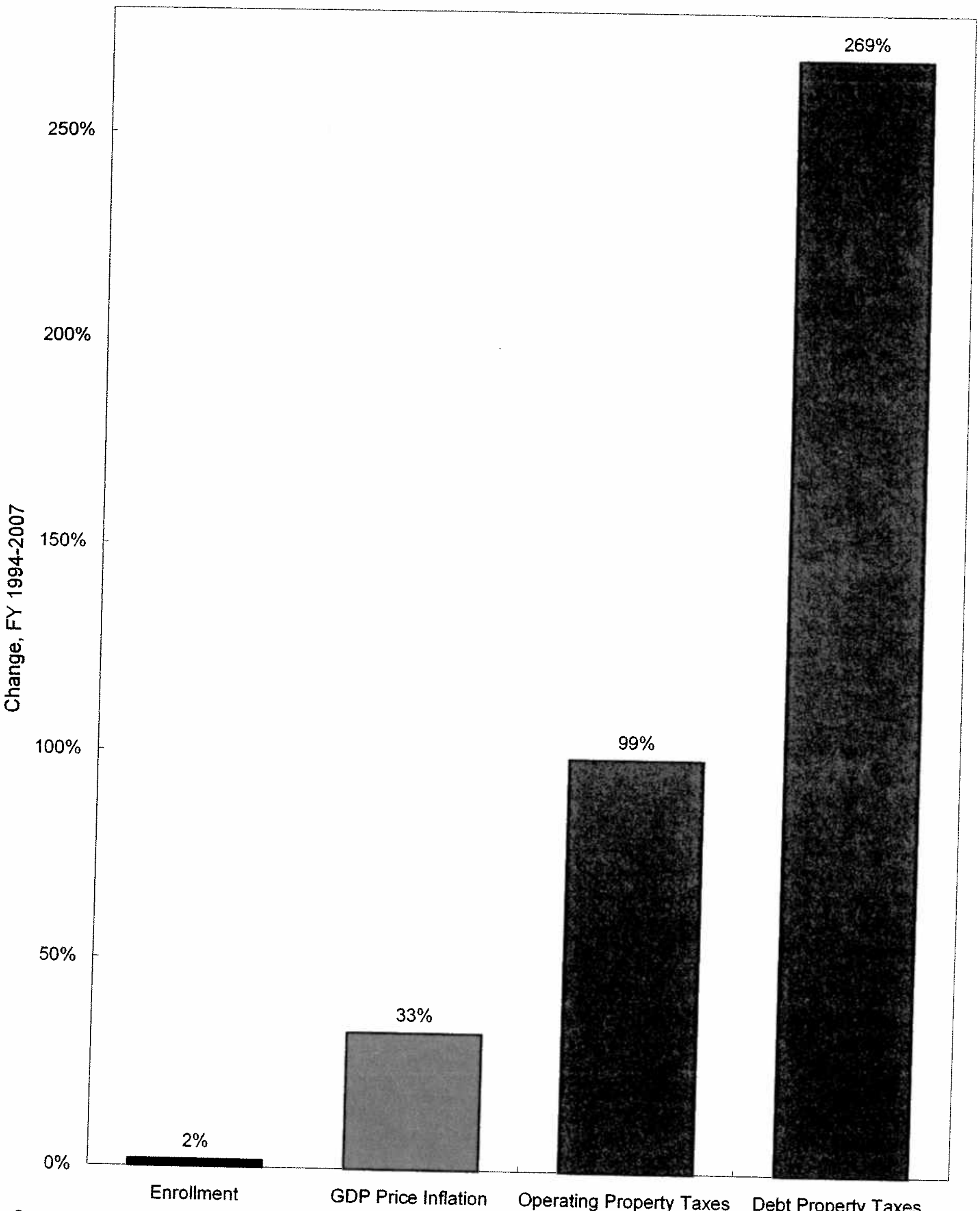
Michigan Public Schools: Enrollment, Price Inflation, and Property Tax Revenue Since "Proposal A"



Source: Anderson Economic Group, LLC
Data: Michigan Dept. of Education; Michigan State Tax Commission; U.S. Bureau of Economic Analysis

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Michigan School Property Tax Revenue

Tax Year	Operating Taxes Amount (billions)	Operating Taxes Millage Rate	Debt, Building and Site, Sinking Funds Amount (millions)	Debt, Building and Site, Sinking Funds Millage Rate
1985	$ 3.64	35.4	$ 289	2.8
1986	$ 3.81	35.9	$ 295	2.8
1987	$ 4.05	36.4	$ 308	2.8
1988	$ 4.44	37.3	$ 322	2.7
1989	$ 4.89	37.9	$ 365	2.8
1990	$ 5.34	38.2	$ 364	2.6
1991	$ 5.77	38.3	$ 403	2.7
1992	$ 5.98	38.8	$ 435	2.8
1993	$ 6.38	38.0	$ 455	2.7
1994	$ 3.41	19.5	$ 454	2.6
1995	$ 3.57	19.6	$ 554	3.0
1996	$ 3.76	19.6	$ 639	3.3
1997	$ 3.89	19.2	$ 736	3.6
1998	$ 4.11	19.1	$ 805	3.7
1999	$ 4.32	19.0	$ 886	3.9
2000	$ 4.54	18.9	$ 986	4.1
2001	$ 4.95	19.2	$ 1,125	4.4
2002	$ 5.31	19.3	$ 1,260	4.6
2003	$ 5.24	18.1	$ 1,342	4.6
2004	$ 5.82	19.1	$ 1,441	4.7
2005	$ 6.12	19.0	$ 1,516	4.7
2006	$ 6.45	18.9	$ 1,605	4.7
2007	$ 6.79	19.0	$ 1,675	4.7
Change 1994-2007	*$ 3.38* [redacted]		*$ 1,221.00* [redacted]	
Change 2006-07	*$ 0.34* *5.3%*		*$ 70.00* *4.4%*	

Source: Anderson Economic Group

Data: Michigan State Tax Commission; Ad Valorem Property Tax Levy Reports, 1996 - 2007, and the *2000 Economic Report of the Governor*, Michigan Office of Revenue and Taxation

Notes:
STC confirms that debt, building and site millage also includes sinking fund millage.
For 2003 only the SET rate was 5.0 mills.
Operating Taxes include the SET, Regular School Taxes, and Extra Voted Operating Taxes
"Year" is calendar year in which fiscal year ends.

ANDERSON ECONOMIC GROUP

Memorandum

Date: May 23, 2006

To: Rich Studley, Michigan Chamber of Commerce

From: Scott D. Watkins, Consultant
Patrick L. Anderson, Principal

Re: Analysis of Proposed House Bills 4575 & 5709; "Sinking Fund" expansion; Tax Limits under "Proposal A"

Cc:

I. Summary

There are currently two bills (4575 & 5709) in the House that would greatly expand the allowable uses of "sinking funds" by school districts. We evaluated very similar bills in the past, including HB 4824 from 2001. In this memo, we provide a brief summary of bills 4575 and 5709. We also revisit our June 2002 report which includes the fiscal implications of expanding the allowable uses of sinking funds, and illustrates the rapid increase in property taxes for school infrastructure projects that occurred after Proposal A.

II. Property Taxes for School Capital Projects Since Proposal A

Figure 1 in our 2002 report showed that, from 1994 to 2000, property taxes for school capital projects (includes sinking fund, bond, and capital millege revenue) increased by just over 117%, despite low enrollment growth and price inflation. This explosion has continued. By 2004, the most recent year for which data is available, total growth in property tax revenue for school capital projects since Proposal A (1994) reached a staggering 217%.

This is shown in the attached graph titled "Michigan Public K-12 Schools, Enrollment, Price Inflation, and Property Tax Revenue since Proposal A."

III.$5.4 Billion Estimated Property Tax Increase

In our 2002 report we simulated the effects of increased school sinking fund tax authority over a ten-year period, under 3 scenarios. Our findings, are summarized in the below table. Note that this has not been updated to account for the increase in property values that has occurred since 2002, so the likely property tax increase in 2006 and thereafter can be expected to be even larger.

	Cumulative Property Tax Increase (billions)	Residential Burden	Non-Residential Burden
Scenario One, 2.5 mill avg increase	$5.43	$3.37	$2.06
Scenario Two, 1.5 mill avg increase	$3.26	$2.02	$1.24
Scenario Three, 3.5 mill avg increase	$7.60	$4.71	$2.89

Source: Anderson Economic Group LLC

Scenario one assumes an average statewide increase of 2.5 mills on both real and personal property taking place over the ten years following passage of the bill. This is equivalent to half of the school districts levying the 5-mill tax by the end of the ten-year period. This closely reflects the trend that occurred from the time at which the allowable debt millage purchase was liberalized (1994) through 2000. Over these 6 years the statewide average millage for debt, sinking fund, and building & site taxes increased .25 mills a year.

Scenario two and three assume different total mills, but remain consistent in assuming that the average millage increases 1/10 of the total change each year for ten years.

IV. Summary of House Bill 4575

House Bill 4575, as introduced on March 24, 2005, appears identical to HB 4824 from 2001. If passed, the legislation will greatly increase the scope of projects that school districts could fund with sinking funds. Although "sinking funds" were originally intended only to pay for capital expenses, the bill would allow "sinking fund" taxes to fund:

- Purchasing, erecting, completing, remodeling, or equipping or re-equipping school buildings, including library buildings, structures, athletic fields, playgrounds, or other facilities, or parts of or additions to those facilities.
- Furnishing or refurnishing new or remodeled school buildings.
- Acquiring, preparing, developing, or improving sites, or parts of or additions to sites, for school buildings, including library buildings, structures, athletic fields, playgrounds, or other facilities.
- Purchasing school buses.
- Acquiring, installing, or equipping or re-equipping school buildings for technology.
- Refunding all or part of existing bonded indebtedness if the net present value of the principal and interest to be paid on the refunding bonds, excluding the cost of issuance, will be less than the net present value of the principal and interest to be paid on the bonds being refunded, as calculated using a method approved by the Department of Treasury.
- Accomplishing a combination of the above purposes.[1]

1. Revised School Code, 1976 PA 451, section 1351a.

Passage of such a law would effectively allow schools to increase their operating tax revenue, by using "sinking fund" revenue to cover repair, maintenance, refurbishing, "technology," and furnishing costs that would normally be paid out of operating funds. This would encourage more school districts to seek voter approval of sinking funds, "and thus increase property taxes for residents approving these proposals"[2] and further erode the tax limitations adopted under Proposal A of 1994.

V. Summary of House Bill 5709

House Bill 5709, as introduced on February 16, 2006, would allow school districts to create a sinking fund for "the purchase of school buses or the acquisition, installation, or equipping or reequipping of school buildings for technology." The bill includes language that prohibits a sinking fund from being used to fund software upgrades and applications; media, including CDs and disks; and training, consulting, maintenance, service contracts, software upgrades, troubleshooting, or software support. It also defines "technology" more clearly than prior legislation has, and indicates that "School Bus" means that term as defined in section 7 of the Pupil Transportation Act (1990 PA 1990).

Although this version includes some definitions that previous versions lacked, this does not change the fundamental problem: these are not long-term assets. Bond and sinking fund millages can be prudent vehicles to raise funds for capital projects—those that create long-term physical capital, such as buildings and land. However, to allow them to be used as a supplement to operations is imprudent, if not reckless. Short-lived assets like school buses and "technology" have a useful life of three to seven years—imprudent expenditures for debts repaid over ten or twenty years.[3] This is exactly the reason that banks do not provide the option of financing a car or computer over a 10-year period: the collateral is gone long before the loan would be repaid.

VI. June 2002 "Sinking Fund" Report

The Michigan Chamber of Commerce commissioned our firm to complete an analysis of the likely impacts of HB 4824 in the 2001-2002 legislature. After conducting our research we issued the report "Infrastructure Investment, or Backtracking on Proposal A," in June 2002. This report, which remains available on the Anderson Economic Group web site and the Michigan Chamber of Commerce web site, covered:

- The taxes funding Michigan K-12 Schools
- The tax limits under Proposal A, including the requirement for a 3/4 super-majority vote on legislation that would increase the amount of ad valorem property taxes that can be levied for school district operating purposes.
- School bonds, Building and Site millages, and Sinking Funds.

2. Senate Fiscal Agency analysis of HB 4825, from 2001.
3. The useful life of such expenditures can vary, but the Internal Revenue Code is a good guide. Sections 1245 and 1250 of the Code list cars, light and heavy duty general purpose trucks, qualified technology equipment, and computers and peripheral equipment as depreciable five-year property. See, e.g., *Master Tax Guide*, Chicago, Commerce Clearing House, various years; paragraph 1240.

   The Internal Revenue Code tends to exaggerate the useful life of assets, as this approach increases tax collections. Many taxpayers expense immediately a good share of "technology" expenditures, noting that operating system and application software; computers and peripherals; and wiring, PDA's, telecom equipment and accessories are often obsolete within two to three years.

- Changes in school finance since Proposal A in 1994.
- The estimated fiscal impact of expanding the allowable uses of sinking funds (as HB 4824 from 2001 and the current HB 4575 propose doing).

Given that the language in HB 4575 matches HB 4824, the conclusions from the 2002 report still hold. However, the size of the fiscal impact is likely to be greater now given increases in taxable value.

3/4 Super Majority Requirement. Under Proposal A, there is a requirement for a 3/4 super-majority vote in both chambers to pass laws that increase statutorily established school operating millage rates. These statutory tax limits were listed in a memorandum authored by deputy directors of the Budget and Treasury departments before Proposal A was passed, and distributed by the Governor shortly afterwards.

Specifically listed are sections of the school code governing the allowable school operating taxes, including those that debt, sinking fund, and building & site taxes. See the last bullet point on page three of the attached 1994 memorandum to Governor John Engler from Patrick L. Anderson, then deputy budget director; and Nick Khouri, then chief deputy treasurer.

Very soon after Proposal A passed, there were attempts to increase the limits on operating taxes through an expansion of the use of these millages. One such bill, SB 597, was passed by the legislature. Governor John Engler vetoed this bill, stating in his message "we cannot stand by and let that historic step forward be reversed piecemeal by those that preferred the old school finance system--a system that was unfair to students and taxpayers alike." The veto was of SB 597, which would have allowed the use of sinking funds for technology purposes, as well as an increase in the allowable purposes for bond funds, but did not receive a 3/4 vote. Governor Engler's veto message is attached.

VII.Conclusions

As discussed above, our analysis has found:

1. As illustrated by the 217% increase in property tax revenue for school capital projects between 1994 and 2004, school districts are not without options for generating capital revenue under current law. Most of this enormous increase in school capital funding occurred during a period during which operating funds were also increasing rapidly, and enrollment was growing slowly.

2. House Bills 4575 and 5709 will result in a $5.4 billion property tax increase over the next ten years. This estimate is from our June 2002 analysis of a similar bill that aimed to greatly expand the allowable uses of sinking funds.

   In this 2002 analysis we used a conservative assumption (that the equivalent of only half the school districts eventually levying a 5-mill tax, with the gradual adoption of the property tax increase over a ten-year period), and estimated a $3.4 billion cumulative property tax increase over the ten-year period on residential real estate, and an additional $2.1 billion cumulative property tax increase for business property.

3. In addition to circumventing the Proposal A limits, House Bills 4575 and 5709 would also encourage fiscal irresponsibility. In particular, "sinking funds" could be

used to purchase short-lived assets, such as "technology" and school buses. Thus, long-term money would be used to finance short-term purchases. If sinking funds are used to finance short-term purchases, the funds will be depleted when long-term funding, such as for a major construction project, is required.

4. The current sinking fund bills, House Bill 4575 and 5709, both clearly increase the maximum *ad valorem* property taxes that may be levied for school operating purposes. Therefore they require under Proposal A a 3/4 affirmative vote of both the House and Senate for adoption. Note that both House and Senate rules also require this 3/4 vote.

5. Proposal A allowed voters to adopt permanent tax increases (a new state property tax, an increase in the sales tax, and a new property transfer tax), in return for expanded state funding for schools, and permanent property tax limitations.

6. The key tax limitation included in Proposal A was a super-majority requirement to change any of the statutory limitations on tax revenue raised for school operating purposes, as those statutes were on March 15, 1994. Those statutes were identified in a March 2, 1994 memorandum written at that time by Patrick Anderson and Nick Khouri, who were employed at the time as deputy budget director and deputy treasurer, respectively.

7. One of those statutory tax limits protected by Proposal A was a restriction on the use of revenue for "sinking fund" and capital expenditure purposes, and the ability to levy taxes for those purposes.

8. Before the amendment had become effective, the legislature passed SB 597 to expand the use of sinking funds. Governor Engler vetoed these bills, stating that they would circumvent the tax limits in the Constitutional amendment the voters had just adopted.

9. The intent and result of the bills vetoed in 1994, the bills considered in 2001, and the bills before the legislature today are all the same: They allow school districts to raise operating tax revenue by using property tax millage that was not intended to cover operating expenditures. In particular, both "sinking fund" and "bond" funds are intended to accumulate funds to pay for *capital* expenses such as the acquisition of property and the construction of buildings.

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